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E.O. 12958: DECL: 04/25/2012
TAGS: ECON EFIN ETRD PGOV HU
SUBJECT: COVERING THE WATERFRONT: NATIONAL BANK CHAIRMAN ON DOMESTIC REFORMS AND REGIONAL COMPETITIVENESS

REF: BUDAPEST 532 AND PREVIOUS

Classified By: P/E COUNSELOR ERIC V. GAUDIOSI; REASONS 1.4 (B) AND (D)

¶1. (C) Summary: Hungarian Central Bank (MNB) Chairman Andras Simor shared his views on Hungary's economic trends and their political impact with G-8 Ambassadors April 17. He expressed particular concern re Hungary's lagging growth rate, the continuing challenge of reforming attitudes as well as regulations, and the temptation of renewed spending as the elections of 2009-10 approach. End Summary.

¶2. (C) Opening with a reference to recent statistics reflecting dramatic increases in per capita GNP in Slovakia, Simor commented that the public should react to the news that their "little brother" is surpassing them economically but questioned whether Hungarians "really get it."

¶3. (C) Simor noted encouraging progress in reducing Hungary's deficit, but believes the good news has been "poorly communicated to the public." He also credited the government with making "structural and sustainable cuts" rather than taking limited steps with short-term impact.

¶4. (C) But, he continued, the government still faces numerous challenges including:

Health Care Reform: Although he believes many of the changes are already in train, he emphasized that the sector had always been driven by the government and not by the market. He believes hospitals still see few incentives in reforming their operations, and sees "changing the concept" remains the most difficult problem, and he believes the government "can't do this alone." Nor, he continued, is there "an ideal model" to which to turn. Although a multi-player system will help in his opinion, he believes the governing MSZP party is "divided at best" on the issue and cautioned that political will could "evaporate," leading to skyrocketing health care costs in the future.

Education: Simor was more optimistic about the impetus to reform in the educational sector, and believes that schools are becoming more cost-conscious as the focus shifts from the quantity of students to the quality of the education.

Pensions: Simor stated that the government "should go further" by extending the retirement age, changing the retirement index to one based solely on inflation, and abolishing the "13th month" payments. He cautioned that the number of pensioners is "growing too quickly already," but commented that the MSZP will be hesitant to take steps given their strong support from retirees.

Administrative Costs: Simor described the government's approach as "bold promises ... and no results." He advocated

the introduction of steps including incentive pay, performance reviews, and efficiency benchmarks as ways to start the slow process of "reforming our culture."

He added that the MNB should not be exempt from this process, signalling his intention to look for ways to down-size staff while maintaining the Bank's level professional expertise. Simor also favors steps to reduce Hungary's Monetary Council from 13 to 5-7. He believes this can be done through a process of attrition ending in 2011, and would also like to change the Council's composition by adding more "internal experts" to roughly balance the number of "outside representatives."

Taxation: Hungary, Simor remarked, cannot afford to reduce its tax revenues but must shift its tax burden. He believes the government should move forward on a real estate tax and on increases to the VAT, but predicts "even more problems" with pensions than on health care.

Inflation: Simor believes that the inflation rate will stabilize at 5% by the end of the year and that a longer-term rate of 3% is possible, although deregulation and wage settlements pose "a real danger."

Political Temptation: Simor concluded by underscoring the risk that the European Parliament elections of 2009 and the national elections of 2010 will undermine fiscal discipline in the long-term. He suggested tighter limits on medium-term spending as a means to limit the excesses of politically-motivated spending.

¶5. (C) Comment: Simor is off to a strong start at the Bank. His remarks reflect a much broader view of the economy than his predecessor's, and his personal stature may allow him to use his new position to promote the reform process. We note that his comments regarding the obstacles to Hungary's competitiveness track closely with those of our contacts in the business community, who have expressed their concern regarding the prospect of a "double dip" should Hungary experience another year of minimal economic growth. End Comment.

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